

the aftermarket analyst

A PUBLICATION FOCUSED ON MERGERS, ACQUISITIONS AND CORPORATE FINANCE IN THE AUTOMOTIVE AFTERMARKET INDUSTRY

Distribution Challenges, Part II: The Repercussions of OEM Vehicle Differentiation

Over the last few months, we have discussed the changes in the aftermarket's traditional distribution system, particularly as they relate to WDs and aftermarket accessories. In this issue, we will discuss trends in two more distribution channels:

Retailers

A current trend that we expect to have a significant impact on the aftermarket is the battle between the retailers' limited shelf space and SKU proliferation. These retailers can no longer carry the vast assortment of model-specific accessories available today. The OEMs' push for vehicle differentiation has caused a geometric increase in the number of vehicle models, particularly for light trucks. This increase has heightened the retailers' dilemma regarding which products to stock, and this dilemma is particularly evident for large application-driven items such as hood shields.

Specialty accessories are built on the premise that vehicle personalization is desired, and consumers have reinforced this belief as specialty accessory sales have been a large driver behind the growth of the aftermarket. As OEMs further embrace the concept of differentiation, manufacturers will be forced to adapt by producing an increasing number of SKUs. Whether the retailers will buy them is another story. They will not be able to meet customers' demand by stocking all of the products. One

alternative for them is to focus solely on the most popular vehicles designs and then face the customers' wrath when they don't have the right product in stock. Another is to drop ship, but this has shown to be cost-effective primarily for higher-dollar items.

OEMs

The OEMs' push towards greater vehicle differentiation is affecting the aftermarket in several other ways. The challenge for aftermarket manufacturers is in keeping up with the pace of change and the sheer volume of the increased number of SKUs. Often, the OEMs are quick to change specifications with no advance notice to manufacturers, which are sometimes unaware of the OEM changes until the vehicle is at market. More importantly, any specialty equipment manufacturer of model-specific aftermarket products will now have to make more versions, leading to a significant increase in tooling and equipment costs for the manufacturer. The TS certification required by most OEMs also increases manufacturing costs. Moreover, the costs of the legal complexities and intricacies of producing for the OEMs' worldwide platforms are not for the faint of heart.

OEM dealer networks stand to benefit from vehicle differentiation via their intimate knowledge of new product introduction. The OEMs are trying to sell more

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RECENTLY ANNOUNCED AUTOMOTIVE AFTERMARKET TRANSACTIONS

Announce Date	Acquirer/Investor	Target	Target Description	Firm Value (\$mil.)	Rev. FV / Rev.	EBITDA FV / EBITDA
11/19/2007	Kinderhook Industries	Extang Corporation	manufacturer of soft tonneau covers for the light truck market.	—	—	—
11/19/2007	Kinderhook Industries	TruXedo	manufacturer of soft tonneau covers for the light truck market.	—	—	—
11/12/2007	Brembo North America	Hayes Lemmerz' Automotive Brake Components	production facilities in Homer and Apodaca, which manufacture brake rotors and drums for the North American passenger car and light truck markets	\$58.0	0.5x	—
11/6/2007	Compass Automotive Group, LLC	Alcoa's Automotive Castings business	manufactures a full range of safety-critical suspension and chassis components, including sub-frames, cradles, and engine brackets	—	\$150.0	—
11/1/2007	Freudenberg-NOK General Partnership	Precision Industries Corp.	manufacturer of fabric-reinforced diaphragms for small engines, fuel systems, irrigation, gaseous fuels, and pneumatic controls	—	—	—
10/30/2007	Centric Parts	Power Performance Group, Inc.	manufacturer of the Power Slot brand of performance brake products	—	—	—
10/26/2007	Franchise Capital	Dr. Gas	produces 90% of all exhaust systems used in NASCAR.	—	—	—
10/26/2007	Pilot Automotive	Design Motorsports Engineering	manufacturer of engineered performance exhaust, diversion panels and engine dampers	—	—	—
10/26/2007	Pilot Automotive	DC Sports	manufacturer of cat-back exhaust systems, ceramic headers, stainless steel headers and strut tower bars	—	—	—
10/26/2007	Uni-Select	Replacement Parts Depot Limited	automotive replacement parts distributor that operates a large warehouse in the Greater Toronto Area	—	—	—
10/23/2007	American Capital Strategies	Imperial Supplies LLC	Green Bay, Wis.-based distributor of aftermarket components to fleet and facility-based markets.	112.0	—	—
10/22/2007	Wynnchurch Capital	GDX International Holdings Ltd.	supplier of sealing systems and glass encapsulation products for the automotive sector	755.0	—	—
10/17/2007	Renco Group Inc.	Delphi Corp.'s Interiors and Closures business	Manufacturer of instrument panels, consoles, cockpits, door modules and latch systems	1,300.0	—	—
10/16/2007	Dubin Clark & Co. (B&M Racing)	Classic Motorsports Group	Tremec overdrive transmission conversion kits for classic cars	—	—	—
10/16/2007	Sentinel Capital Partners	Vintage Parts	supplier of original slow moving and inactive OEM replacement parts	—	—	—
10/15/2007	Greenbriar Equity Group LLC	Grakon	designs, manufactures and supplies lighting systems and engineered trim components to North American and European commercial vehicle manufacturers	—	—	—
10/5/2007	Fisher Auto Parts	Hayden's Auto Supply	based in Leonardtown, MD, Hayden's Auto Supply operates four large stores	—	—	—
10/5/2007	Kinderhook Industries	Blitz USA	manufacturer of plastic gas cans in the United States.	—	—	—

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vehicles and help their dealer bases by having them accessorize more units. Many products that were previously only available via the aftermarket are becoming available as factory options, driving more and more aftermarket products (and consumers) into the hands of the OEMs. Many of these accessories are designed by the OEMs (who may or may not use incumbent aftermarket manufacturers to produce their products) and then sold through the OEMs' distribution channels.

So where does all of this lead us? Two thoughts:

- The increased costs to the manufacturer and the changes in distribution point to the necessity of larger, stronger, more financially sound manufacturers, i.e., a consolidation of the manufacturing base.
- In this new era of increasing SKUs and quicker new product introduction by the OEMs, the advantage will go to manufacturers that can distribute via the internet or through auto dealer networks. The benefits of the internet are expediency and the obvious lack of "brick and mortar" retail space. A recent SEMA survey indicated that the internet is already the number one method of purchasing specialty equipment parts and accessories. The consumers are already "pulling" products through this channel, and there's no turning back. As Mr. Cronkite appropriately phrased it, "That's the way it is."

Capstone Announces Simultaneous Transactions



While we are hesitant to discuss Capstone transactions in this forum, we deemed it important to emphasize the significance of these two transactions. We see these consolidation plays in every auto aftermarket segment – performance parts, chemicals, appearance products, and certainly truck accessories. The industry is undergoing more fundamental changes than we've seen in our 20 years of covering it. There is a paradigm shift happening across multiple distribution channels, and, as the rule goes, when a paradigm shift occurs, everybody is set back to zero, creating a new level playing field and new starting block. These deals become the basis of the new playing field.

These concurrent transactions are also further evidence of the "changing of the guard" throughout the auto aftermarket industry, particularly as they relate to the immense amount of dollars invested in the industry by private equity firms. Many of the original owner operated companies have morphed from purely entrepreneurial enterprises to organizations that are professionally managed, sophisticated, and now backed by institutional investors with an emphasis on maximizing shareholder value.

About Capstone

Capstone Financial Group is an investment banking firm which assists owners of middle market companies with their financial needs - including mergers and acquisitions, recapitalizations, private placements, divestitures, and other financial advisory services. Capstone is backed by a highly experienced and knowledgeable team of financial professionals with firsthand knowledge of starting, operating, growing, and selling middle market companies. Visit us online at www.capfg.com.

Selected Public Company Capitalization and Operating Figures
(\$ in millions, except per share data)

Company	Enterprise Value				Last Twelve Months (LTM)				
	Price as of 10/31/07	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	Net Income
Manufacturers									
Tenneco Automotive, Inc.	\$30.61	\$1,425.4	\$1,536.0	\$203.0	\$2,844.0	9/30/07	\$5,831.0	\$446.0	\$84.6
Aftermarket Technology Corp.	34.52	763.6	0.0	20.7	766.1	9/30/07	523.7	78.6	40.6
Directed Electronics, Inc.	2.47	62.5	309.9	5.5	367.0	9/30/07	459.5	53.5	8.9
Standard Motor Products, Inc.	8.36	154.0	344.6	19.4	479.1	9/30/07	792.0	53.8	14.9
Dorman Products, Inc.	14.06	248.7	25.7	6.1	275.0	9/30/07	321.1	42.5	20.4
Wholesalers & Distributors									
Genuine Parts Company	\$49.07	\$8,238.9	\$500.0	\$330.1	\$8,559.2	9/30/07	\$10,758.9	\$915.1	\$499.7
LKQ Corporation	38.56	2,567.2	12.5	225.3	2,529.7	9/30/07	916.6	112.0	54.6
The Coast Distribution System, Inc.	5.90	26.1	35.7	1.1	60.8	6/30/07	165.3	2.3	(0.3)
Retailers									
Autozone, Inc.	\$124.41	\$8,076.1	\$0.0	\$0.0	\$8,209.6	8/25/07	\$6,169.8	\$1,214.7	\$595.7
Advance Auto Parts, Inc.	34.12	3,488.0	350.4	82.6	3,790.7	7/14/07	4,753.6	567.1	238.2
O'Reilly Automotive, Inc.	33.02	3,799.5	100.5	109.8	3,855.2	9/30/07	2,476.4	370.4	193.7
The Pep Boys - Manny, Moe & Jack	14.71	759.4	671.4	26.6	1,404.2	8/4/07	2,241.9	127.3	(2.3)
CSK Auto Corporation	11.40	501.1	524.4	23.3	1,003.2	5/6/07	1,917.0	136.4	27.1
US Auto Parts Network, Inc.	8.40	250.6	1.1	43.3	208.4	6/30/07	160.9	12.5	1.2

Selected Public Company Multiples and Operating Statistics

Company	Enterprise Value /					P / E Ratio	Margins		
	Revenue	EBIT	EBITDA	Free Cash Flow (2)	Net Income		Gross Margins	EBITDA Margins	Net Margins
Manufacturers									
Tenneco Automotive, Inc.	0.5x	11.5x	6.4x	9.9x	33.6x	16.8	12.7%	7.6%	1.5%
Aftermarket Technology Corp.	1.5x	12.0x	9.7x	13.6x	18.9x	18.8	24.0%	15.0%	7.8%
Directed Electronics, Inc.	0.8x	8.3x	6.9x	7.3x	41.3x	7.0	31.3%	11.6%	1.9%
Standard Motor Products, Inc.	0.6x	12.3x	8.9x	12.2x	32.1x	10.3	26.4%	6.8%	1.9%
Dorman Products, Inc.	0.9x	7.9x	6.5x	7.5x	13.5x	12.2	34.3%	13.2%	6.4%
Mean	0.8x	10.4x	7.7x	10.1x	27.9x	13.0x	25.8%	10.9%	3.9%
Median	0.8x	11.5x	6.9x	9.9x	32.1x	12.2x	26.4%	11.6%	1.9%
Wholesalers & Distributors									
Genuine Parts Company	0.8x	10.3x	9.4x	10.7x	17.1x	16.5	31.5%	8.5%	4.6%
LKQ Corporation	2.8x	25.8x	22.6x	34.0x	46.3x	47.0	45.0%	12.2%	6.0%
The Coast Distribution System, Inc.	0.4x	40.4x	25.9x	60.5x	NM	NM	17.4%	1.4%	NM
Mean	1.3x	25.5x	19.3x	35.1x	31.7x	31.8x	31.3%	7.4%	5.3%
Median	0.8x	25.8x	22.6x	34.0x	31.7x	31.8x	31.5%	8.5%	5.3%
Retailers									
Autozone, Inc.	1.3x	7.8x	6.8x	8.3x	13.8x	13.6	49.7%	19.7%	9.7%
Advance Auto Parts, Inc.	0.8x	9.0x	6.7x	11.7x	15.9x	14.6	48.0%	11.9%	5.0%
O'Reilly Automotive, Inc.	1.6x	12.6x	10.4x	27.2x	19.9x	19.6	44.4%	15.0%	7.8%
The Pep Boys - Manny, Moe & Jack	0.6x	36.5x	11.0x	19.7x	NM	NM	25.9%	5.7%	NM
CSK Auto Corporation	0.5x	10.5x	7.4x	10.3x	37.0x	18.5	47.0%	7.1%	1.4%
US Auto Parts Network, Inc.	1.3x	70.3x	16.7x	22.7x	NM	NM	32.2%	7.8%	0.7%
Mean	1.0x	15.3x	9.8x	15.4x	21.7x	16.6x	41.2%	11.2%	4.9%
Median	0.8x	10.5x	8.9x	11.7x	17.9x	16.6x	47.0%	11.9%	6.4%

(1) Enterprise Value equals market cap, plus debt, minus cash

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful